Sept. 15, 2023

Stoner Cats: Another Example of the SEC Targeting NFTs

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On September 13, the U.S. Securities and Exchange Commission settled enforcement proceedings against the maker of the Stoner Cats web series arising from its sale of non-fungible tokens (NFTs), reflecting a significant expansion of the SEC's crypto enforcement efforts into the NFT space.

The SEC charged Stoner Cats with conducting an unregistered offering of crypto securities when it raised approximately $8 million through an NFT sale to finance a new web series. Stoner Cats agreed to a cease-and-desist order and civil penalty of $1 million without admitting or denying the SEC's findings.

The SEC's position in the Stoner Cats proceeding has broad implications for NFT issuers. The Stoner Cats NFTs were uniquely generated images of web series characters that gave owners exclusive access to view the Stoner Cats series on the Internet. At first blush, one might conclude that this makes them no different in nature than a combination of unique artwork and tickets to a Knicks game. The SEC, however, focused on specific characteristics of the Stoner Cats NFTs and the manner in which they were marketed in concluding that the NFTs were not products, but investment contracts.

The SEC emphasized, among other things, that the Stoner Cats NFTs:

- were allocated to purchasers randomly—purchasers could not select which character images to buy;
- carried no commercial intellectual property rights in the images;
- were sold telling purchasers the proceeds would be used to develop the series and marketed to emphasize resale options on the secondary market ("the more successful the show, the more successful your NFT");
- could be acquired in bulk, even though only one was required to access the web show; and
- carried a royalty of 2.5% for secondary market sales which, along with the offering proceeds, were paid to writers, animators, and voice actors to develop the series.

In light of these characteristics, the SEC concluded that the "economic reality" of the offering was such that purchasers were led "to expect profits because a successful web series could cause the resale value of the Stoner Cats NFTs in the secondary market to rise." As the Director of the SEC's Division of Enforcement noted in the accompanying press release:

> "Regardless of whether your offering involves beavers, chinchillas or animal-based NFTs, under the federal securities laws, it's the economic reality of the offering—not the labels you put on it or the underlying objects—that guides the determination of what's an investment contract and therefore

> a security…. Here, the SEC's order finds that Stoner Cats marketed its knowledge of crypto projects, touted that the price of their NFTs could increase and took other steps that led investors to believe they would profit from selling the NFTs in the secondary market."

The SEC's enforcement action against Stoner Cats is another example of the Commission's stepped-up enforcement of crypto assets as securities. Whether the SEC's analysis of the governing _Howey_ factors in the context of NFT projects like Stoner Cats would hold up to scrutiny in court, the fact remains: The current SEC will not shy away from pushing the boundaries of the law in enforcement proceedings in the crypto space.

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